ARIZONA LEGISLATIVE STAFF GUIDE

TO

STATE AND LOCAL BONDS AND DEBTS

Arizona Legislative Council
David M. Thomas, Deputy Director

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Arizona Legislative Staff Guide to

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CONTENTS

I. INTRODUCTION

In the United States, governments must budget their finances by comparing their income from all sources against the seemingly infinite demands for expenditure. Normally, and preferably, the government will pay its expenses with current income on a "pay-as-you-go" basis. Frequently, however, government programs and projects are of such a scale that their costs overwhelm the revenues and can only be financed by going into debt. Bonds allow the government to acquire expensive assets that it could not afford on a pay-as-you-go basis

Municipal debt financing has been around for a long time. Italian city-states borrowed money from merchant banking families during the Renaissance. Borrowing by U.S. cities dates from the seventeenth century, and by the 1840's amounted to around $25 million. Thereafter, urban growth and the establishment of a free public education system caused government debt to expand explosively. Today government debt financing has developed into a major specialized industry.

Governmental entities must have statutory authority to perform any of their powers, including borrowing money. The Arizona Revised Statutes (A.R.S.) contain many articles and chapters full of detailed, esoteric provisions to enable debt financing to occur for numerous specific purposes. Most of these provisions are drafted to meet the specific requirements of the debt financing marketplace, which are outside the normal experience and expertise of legislative staff.

This primer is intended to provide summary guidance and background for staff who must work with those statutes and allow staff to develop at least a conversational knowledge of the subject. Staff should understand that this report is not a legal treatise nor is it intended to be a source of legal authority. It may, however, be used as a reference for general information on the subject, as a treatment for insomnia and for memorization in order to impress friends and colleagues.

II. DEBTOR ENTITIES

A. The State of Arizona:

When Arizona became a state, the founding fathers included provisions in the State Constitution that recognized that the state government would incur debt:

> The general appropriation bill shall embrace nothing but appropriations for the different departments of the State, for State institutions, for public schools, *and for interest on the public debt. . .* (Article IV, part 2, § 20, Constitution of Arizona. Emphasis added.)

> [F]or the purpose of paying the State debt, if there be any, the Legislature shall provide for levying an annual tax sufficient to pay the annual interest and the principal of such debt within twenty-five years from the final passage of the law creating the debt. (Article IX, § 3, Constitution of Arizona.)

> *The State may contract debts* to supply the casual deficits or failures in revenues, or to meet expenses not otherwise provided for; but *the aggregate amount of such debts*, direct and contingent, whether contracted by virtue of one or more laws, or at different periods of time, *shall never exceed the sum of three hundred and fifty thousand dollars*; and the money arising from the creation of such debts shall be applied to the purpose for which it was obtained or to repay the debts so contracted, and to no other purpose.
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> In addition to the above limited power to contract debts the State may borrow money to repel invasion, suppress insurrection, or defend the State in time of war . . . (Article IX, § 5, Constitution of Arizona. Emphasis added.)

Considering that the state appropriations for its first fiscal year were slightly over $512,000, the Constitution authorized state debt equaling approximately 2/3 of the amount of the 1912 state general fund budget. The $350,000 limit on state debt has not changed since 1912. Instead, that amount has been devalued by inflation and by the expansion of state government activities and is now a trifling amount in relation to state financing requirements. Thus, without amendment, the state's debt limitation has become today, essentially, a prohibition on meaningful general obligation debt financing by the state.

LEASES AND LEASE-PURCHASES

Leases and lease-purchase agreements by government entities in Arizona are generally not considered to create debts of the lessee government if the agreement does not create a legal obligation of public money beyond the current fiscal year. For example, A.R.S. § 41-791.02 requires that state lease-purchase agreements must include provisions stating that the state's obligation to make lease-purchase payments is a current expense, payable solely from appropriated monies and is not a state debt. If the Legislature fails to appropriate monies for any periodic payment or renewal term of the agreement, the agreement terminates at the end of the current term and the state is relieved of any further obligation.

State courts have held that the limitation/prohibition does not apply to bonds and other instruments that are repayable only from specifically designated sources of money. (See Arizona State Highway Comm'n. v. Nelson, 105 Ariz. 76 (1969).) This interpretation allows the state and state entities to borrow money for state highways (payable from gasoline and motor vehicle taxes), university buildings (payable from tuition, fee and rental income), coliseums (payable from user fees) and other projects that are authorized by law, as long as the debt is not backed by and payable from general state revenues. In general terms, the state can finance projects using revenue bonds, but not general obligation bonds.

B. Counties and Municipalities:

Counties, cities and towns are the other levels of governments in Arizona that possess general government jurisdiction over a broad range of powers such as law enforcement, land use planning and zoning and public health enforcement. Cities in Arizona are further classified as either "charter" cities or "general law" cities, depending on whether their citizens have adopted a charter that grants a measure of "home rule" powers to the city in addition to the powers granted by state law. A general law city must comply with and is limited to the powers granted by state law. A charter city may exercise additional powers as granted by its citizens in adopting its charter.

County and municipal debt financing is specifically authorized by state law for several purposes. Examples include county street and highway improvement bonds (Title 11, chapter 2, article 12, A.R.S.) and municipal bonds for financing utilities (Title 9, chapter 5, article 3, A.R.S.). In addition, both counties and municipalities are allowed by law to create special districts and authorities to engage in debt financing under their own separate identities. (See the discussion of special districts and authorities below.)

Counties and municipalities have always had limits on the amount of debt they can incur at any time. Article IX, § 8, Constitution of Arizona, prohibits county and municipal debt exceeding 6% "of the taxable property" (net assessed secondary property valuation) of the county or municipality, except that:

- The voters of a county may authorize an additional debt increment, not exceeding 15%.
- The voters of a city or town may authorize an additional debt increment, not exceeding 20%, for municipal water, light or sewer projects or for municipal open space,

parks, playgrounds and recreational facilities.

- State courts have interpreted the debt limits to apply only to obligations that are voluntarily incurred, backed by the "full faith and credit" of the county, city or town and payable from general revenues. The provision limits general obligation bonded indebtedness but not revenue bonds. (See City of Phoenix v. Phoenix Civic Auditorium and Convention Center Assoc., 100 Ariz. 101 (1966).)

MUNICIPAL PROPERTY CORPORATIONS

"Municipal property corporation" (MPC) is a generic term describing private nonprofit corporations formed by municipalities specifically as a financing tool to build or buy municipal projects that are then leased back to the municipality. The directors of the MPC are appointed by the city council. Once the MPC is formed, it issues bonds to finance the city project. The security for the bonds is a lease or lease-purchase agreement between the city and the MPC. The MPC is a separate legal entity from the municipality, and its bonds are a debt of the MPC and not of the city for purposes of constitutional debt limits. The only municipal obligation is under the terms of the lease or lease-purchase agreement with the MPC, which is not a municipal "debt" if it is structured correctly (see box on page 2).

Government debt is computed as the principal amount of all outstanding bonds issued by the government debtor except principal that has been paid or for which money has been deposited into a special fund dedicated for paying the principal. The principal amount of a bond is the par amount of the bond exclusive of any premium or discount. (A.R.S. § 35-503.)

C. School, Community College and Other Special Districts:

Special districts are local governments having very limited subject areas of jurisdiction, in contrast to counties, cities and towns, which have general powers. For purposes of this discussion, school districts and community college districts are considered together with flood control districts, irrigation districts and the other districts authorized by law. Special districts may be organized under a county or municipality, such as county and city improvement districts, as well as by citizens acting directly under state law, such as electrical districts. Districts may be formed to allow a more focused or localized area of control over a particular issue of special public interest, or to move particularly expensive projects out from under county or municipal governments and their tax, expenditure and debt limitations.

The defining features of special districts are: (1) a limited subject area of jurisdiction that is specific to the particular type of district (public schools, community colleges, flood control, sport stadium financing, hospital financing), (2) the power to impose taxes or assessments on the general public, which usually includes property taxes, but may also include sales or other taxes, (3) the power to incur governmental debt secured by their general taxing power (general obligation bonds secured by the "full faith and credit" of the district) and (4) a predominantly elected governing board. There are variants of these characteristics evident among the special taxing districts that are codified in Titles 15 and 48, A.R.S., and there is no organic or constitutional requirement that a district have any of these features, but in Arizona they are commonly provided by law.

Special districts may be designated as "municipal corporations" and as "political subdivisions" having the rights, powers and immunities as cities and towns. They are governmental entities. They are exempt from taxation on their governmental activities and property. They function under their own separate identity, in their own name and not as mere state or local agencies. (See Article XIII, § 7, Constitution of Arizona.)

All school districts are subject to limits on the amount of general obligation debt they can incur, similar to municipal debt limitations:

- A common or high school district is limited to general obligation bonded indebtedness of not more than 6% "of the taxable property" in the district.
- The voters in a common or high school district may authorize additional debt, not exceeding 15%.
- A unified school district is limited to debt of not more than 30%.
- These limitations apply only to general obligations that are voluntarily incurred, backed by the "full faith and credit" of the school district and payable from the general revenues of the district.

D. Public Authorities:

In Arizona, a public authority is similar to a special district except for two significant aspects: An authority does not have the power to levy general taxes or assessments and, consequently, cannot issue general obligation bonds. Otherwise, an authority (1) has a limited subject area of jurisdiction, (2) has the power to charge fees or maintain some other stream of revenue to finance its operations, (3) may issue bonds that are secured by that stream of revenue (i.e., revenue bonds) and (4) may have an elected or appointed governing board.

Like a special district, an authority is a governmental entity and is exempt from taxation on its governmental activities and property. Authorities function in their own names and not as state or local agencies.

They may be established by the state (e.g., the Arizona Power Authority, A.R.S. §§ 30-101 et seq.) or local governments (e.g., county sports authorities, A.R.S. §§ 11-701 et seq.). Note that the entities that are designated "regional public transportation authorities" and "regional transportation authorities" (A.R.S. Title 48, chapters 29 and 30) have characteristics of both special districts (tax levying) and authorities (appointed directors).

III. LENDERS/INVESTORS

A. Primary Market:

Government entities wouldn't be able to borrow money to finance their projects if there were no lenders willing to lend money to them. The primary market for municipal bonds consists of investors who buy new bond issues directly from underwriters.

Historically, as one might expect, commercial banks dominated the lending market by buying municipal bonds, but banks were superseded by individual investors (households) and mutual funds in the 1980's. The Tax Reform Act of 1986 had a profound effect on the municipal bond market in several aspects. Some provisions of the act made municipal bonds less attractive to banks and insurance companies while other provisions closed loopholes leaving municipal bonds one of the few remaining significant tax shelters for individuals. In recent years, individual participation in tax-exempt municipal bonds has expanded significantly, not only by direct investment but also through investments in mutual funds and unit investment trusts.

According to the Federal Reserve Board, in 1999, most municipal bonds were held by four categories of investors: mutual funds (about 33.7%), individual households (34.7%), insurance companies (15.0%) and banks (13.2%).

B. Secondary Market:

Municipal bonds would have very little investor appeal if the original buyers had to hold the bonds until their maturity date. Instead, a "secondary market" exists that allows investors to resell the bonds repeatedly during the term of the bonds. After the initial sale, most municipal bonds can then be traded over-the-counter through one of the more than 2,000 banks and securities firms that are registered to buy and sell municipal securities. The secondary market is not a formal market. There is no public listing of secondary offerings, nor is there an organized exchange where brokering occurs.

The secondary market is an important adjunct to the primary market because it provides investors with a mechanism to buy and sell bond holdings prior to their maturity dates, to reduce their chances of being locked into high risk investments and to increase their choice of investment opportunities. It provides the investors with a way to manage their investments and cash flow to suit their individual needs.

There are hundreds of dealers nationwide who serve as agents for investors in bidding and trading municipal bonds in the secondary market. These dealers have developed networks for buying and selling bonds electronically and listing offerings in trade publications or on-line services. The federal Municipal Securities Rulemaking Board regulates the practices of municipal securities dealers, dealer banks and brokerage firms and has codified uniform industry standards for good trading practices and public disclosure rules requiring the government issuers to provide information that could affect the value of outstanding bonds on the secondary market.

IV. PROCESS

A. Preparation:

Government borrowing is a complex, and usually very formal, process, involving many parties and financial considerations and decisions. These must all be brought into play when an entity proposes to borrow money.

Most governments use a financial advisor to serve as a bond market expert and to protect their interests during the entire issuance process. The financial advisor may be an in-house employee in a large government entity or an outside advisor. The financial advisor helps the issuer to make the crucial decisions in the process, such as what type of debt to issue, how to structure the debt and whether to use a negotiated sale or competitive bid process to sell the bonds.

The issuer will employ a bond counsel to prepare a formal legal opinion, printed on the bond certificate, that certifies that the issuer is authorized to issue the bond and has complied with all federal, state and local legal requirements governing municipal debt. The counsel will also issue an opinion whether interest on the debt will be exempt from federal and state income taxes. For bonds issued by the State of Arizona, this legal opinion is frequently required to be issued by the Attorney General. Without this opinion, bonds would be virtually worthless in the tax-exempt market. Bond counsel may also prepare or review and advise the issuer regarding authorizing resolutions, trust indentures, official statements (comparable to a prospectus), other proceedings and litigation.

When the preliminary considerations and decisions have been disposed of, the governing board of the government entity adopts a resolution to incur the debt and issue bonds for the proposed purposes. If the debt is to be secured by the "full faith and credit" of the government (i.e., general obligation bonds) or if otherwise required by law, the government must hold a public election for the voters to approve the bonds. (See Article VII, § 13, Constitution of Arizona.) If approved by the voters, the government can proceed to issue the bonds.

B. Debt Structure:

"Debt structure" refers to the interest rates, the duration and timing of principal and interest payments, the maturity dates, whether a bond issue includes serial bonds or term bonds and the provisions for calling the bonds.

The interest on municipal bonds is affected by outside as well as structural factors. In the long run, municipal bond interest rates track the general fluctuations in rates on other fixed-income securities. In the short term, however, the interest rate is affected by the overall supply of municipal debt and cyclical buying habits of investors. Tax-exempt municipal rates are almost always lower than the interest on taxable securities of equivalent maturity and risk. Other factors outside the issuer's control that affect interest rates include business cycles, inflation and the control of the money supply exercised by the Federal Reserve, the nation's central bank.

A bond's maturity date is the date on which the principal of the bond must be repaid. Until that date, the interest is paid, usually every six months, as a stated percentage of the face value of the bond. The maturity date is usually set to coincide with the useful life of the project being financed to ensure that those who benefit from the project are also those who pay for it. A single bond issue may consist of a series of bonds with different maturities.

The general rule is that the longer the term to maturity, the higher the rate of interest. A longer term bond is usually considered to be riskier than a shorter term bond due to uncertainty about future interest rates and inflation and the increased risk of default over a long term. Ultimately, however, investors' current expectations are what determine the relationship between the maturity of a bond and its interest rate. Economists plot the relationship graphically in the "yield curve" and use the graph to predict inflation, recessions and other economic events.

There are two approaches to structuring the maturity of bonds. A serial bond issue consists of a series of bonds that mature in a regular pattern, such as annually, over the entire life of the issue. Serial bond issues provide a variety of maturities to fit investors' specific needs. A term bond issue has a single final maturity date when the entire principal amount borrowed by the government will be repaid. Term bond issues are frequently used by governments with fluctuating revenue sources because payments of revenue surpluses into a sinking fund can be used to cover periods of revenue shortfall. Government bond issues may occasionally have both serial and term securities in the same issue to benefit from their respective advantages.

A term bond issue is usually financed through the use of a sinking fund into which the government makes payments so that on the maturity date there will be sufficient money available to repay the bonds. The issuer makes periodic payments into the sinking fund to redeem term bonds over the life of the issue to spread out the cost of retiring the bonds. Sinking funds also add a measure of security on the bonds by avoiding one large payment at the bond's maturity. Money in a sinking fund can be used either to redeem the bonds or to purchase equal face amounts in the bond market when the bonds are trading below par.

Bonds can be structured to allow the issuer to redeem or buy the bond back before the maturity date according to various terms and conditions. This is a "call" provision and is the mechanism that allows refunding to occur. Call provisions give the issuer flexibility in controlling its borrowing costs by retiring all or part of its debt.

An issuer will predictably call high interest bonds when it can incur new debt at a lower rate; therefore, callable bonds usually carry a higher interest rate (an extra 0.1% to 0.5%) to offset the bondholders' risk of having their high-yield investment cashed out. The additional interest increment is the "call premium" and is highest when interest rates approach cyclical peaks because of the greater chance of early redemption. Bond issuers frequently include a call protection period of five to ten years during which the bonds cannot be called. Calling a bond is not cost-free, and it becomes harder to attain significant savings as the call option ages due to the shorter period in which savings can be realized. Therefore, the issuer must analyze the cost of the call premium, the difference in interest rates and the length of interest savings when making the decision to call the debt.

Bonds may be issued with extraordinary or "special" redemption provisions to allow the bonds to be retired if unusual events impair the issuer's revenue stream or if a project is not built or if it is damaged or destroyed. Extraordinary redemption provisions may be structured to be mandatory or discretionary with the issuer and are often complex because of the numerous potential circumstances under which they may be used.

C. Creditworthiness:

1. Rating Agencies and Credit Analysis:

In the complex government debt market, investors would have difficulty evaluating whether to purchase a particular bond issue except for the services of private, independent rating agencies that analyze the creditworthiness of the issuing government and the quality of the bonds and notes. The ratings are intended to measure the probability of the timely repayment of a security's principal and interest and allow an investor to evaluate the degree of risk associated with a particular bond. Although they are not legally required, without the ratings, the bonds would not be marketable. Inevitably, the ratings are also used informally and unofficially as a "report card" on the financial health of the issuing government and as a means to rank the government among its peers.

For rating purposes, bonds are classified into two types: Short-term and long-term debt. Short-term debt always has a maturity schedule of less than four years, but many bonds with maturity schedules of less than four years and all bonds with maturity schedules of more than four years are considered long-term debt. This classification allows the rating of comparable bonds and notes on comparable rating scales and allows the investor to compare the rankings of similar investment instruments.

The two principal nationally recognized rating agencies are Moody's Investors Service, Inc. and Standard & Poor's Corporation. The ratings are initially made before the bonds are issued and are periodically reviewed and amended, if necessary, to reflect changes in the issuer's credit position. The agency obtains information from and about each issuer regarding the issuer's demographics, debt burden, economic base, finances and management structure, and identifies factors that figure into the rating of the bonds:

- Economic factors: The economic strength of the issuer is of primary importance. A strong economy with high employment and income levels and a strong tax base usually signify a strong and secure revenue base. A strong revenue base translates into the ability to repay debt. In the case of a revenue bond secured by a revenue stream generated by a government service, the agency will also investigate the level of competition from other entities providing the same service.

- Debt factors: The agency will look at the issuer's debt history and current debt position, the total debt burden (debt per capita or debt as a percentage of personal income or assessed value), the ratio of debt service to revenues, the relationship between the maturity of the bond and the useful life of the asset that is being financed and, finally, the type and strength of the pledged security.

- Governmental and administrative factors: The sophistication and professionalism of the governmental officials influence the credit rating. The agency will examine the government's access to professional services and servicing organizations, the organizational structure of the government, administrative performance, intergovernmental factors and political stability and support. In addition, the agency will determine the availability and examine the quality of financial documents, such as budgets, annual financial reports and capital improvement plans.

- Fiscal and financial performance factors: The agencies also look at the relationship between current liabilities and cash or other liquid assets, the size of fund balances, revenue and expenditure trends and financial audits. A chronic imbalance of funds at the end of the fiscal year reflects poorly on the bond rating report. An agency may also examine the government's potential cash flow and trends in the amount of short-term debt.

- Political factors: The political mood of a community may affect its ability to pay its debts. Although the contractual obligation of issuers to pay off general obligation debt has been consistently upheld by courts, an obligation may not be met if revenues are reduced as a result of public pressure or voter action.

Each rating agency uses a unique grading system to identify gradations of "investment grade" long-term bonds, long-term bonds below investment grade (speculative grade or "junk" bonds), short-term bonds and notes and commercial paper. There is a clear and inverse relationship between bond ratings and the interest rate at which the bonds are issued. The higher the bond rating, the lower the risk of default and the lower the interest rate.

2. Bond Insurance:

An issuer can enhance its creditworthiness by purchasing bond insurance from a private company with respect to a particular bond issue. With insurance, the insurer guarantees to meet the principal and interest payment obligations in the event of issuer default. This obligation lasts for the life of the bond issue and is unconditional, irrevocable and not subject to cancellation by the insurer. Bond insurance only covers the issuer and not the trustee or paying agent.

Bond insurance enables the issuer to get a higher credit rating on the bonds, and therefore pay a lower interest rate. Insurance also provides greater liquidity for issues in the secondary market, for bonds of unknown or infrequent issuers and for bonds with unusually complex repayment arrangements.

Generally, bonds must already be investment grade to qualify for insurance. The insurance company has different considerations from bond rating agencies when evaluating the creditworthiness of an issuer. Bond insurance is a long-term commitment. The insurer cannot change the rating or cancel the insurance. Issues covered by bond insurance receive the insurance company's rating, as distinct from the rating agencies' rating. In practice, although the insurance buys a higher rating, institutions and other sophisticated investors may still distinguish between a true rating and an insured rating on a lower-grade underlying debt.

The issuer must pay an insurance premium up front to get insurance coverage at the time of issue. Unless the savings resulting from reduced interest costs exceed the cost of the insurance, this form of credit enhancement is not useful. The actual amount of the savings from lower interest rates depends on the level of interest rates and the interest rate spreads between the grades of bonds.

3. Letter of Credit:

Another credit enhancement an issuer may use is a letter of credit whereby a provider, typically a major bank, pledges the provider's credit to make principal and interest payments of a specified amount on the issuer's debt for a specified period of time. It provides for the substitution of the provider's credit risk for that of the weaker issuer. The bond rating is then based on the provider's pledge to pay. Of course, if the provider's credit is damaged, the borrower's credit will likewise suffer.

In order for a letter of credit to provide financial advantage, the savings from obtaining a lower interest rate must exceed the costs associated with obtaining the letter of credit. The costs include a commitment fee at the time of the issue and a draw-down fee, which is the interest rate the bank charges in the future if the letter of credit is actually drawn on.

Letters of credit are typically granted for terms of three to five years, rather than the full term of the bond issue, requiring that the government periodically reinstate the letter of credit, or obtain some other form of credit support, several times over the life of the debt. If the issuer cannot obtain a replacement letter of credit, a mandatory redemption of the debt will follow. If the issuer must draw on the letter of credit to pay bondholders, the issuer will then owe the entire amount of the debt to the bank, and interest will accrue at not-tax-exempt rates.

D. Sale:

1. Underwriting:

It is quite unlikely that a workable system could be arranged for the thousands of government debtors to deal directly with hundreds of thousands or millions of individual and institutional lenders. Governments are organized for governing, not marketing, and investors, by themselves, do not have the resources for locating and evaluating all of the available government borrowers. Most issuers do not have the time or resources to market bonds to multiple investors and most investors cannot afford to buy whole bond issues from an issuer. Instead, an intermediary structure, the underwriting process, has been established to serve as the contact link between borrower and lender. Underwriting is the process of purchasing whole bond issues from government issuers and offering those securities to investors, ideally for a profit.

An underwriter is an investment banking firm or a group of firms that purchases bonds directly from a bond issuer and resells them to investors. Frequently a bond issue is too large for a single underwriter to handle. In those cases, a group a underwriters may combine forces in a temporary alliance called a syndicate under the direction of a senior or lead manager who directs the syndicate and coordinates the bond sale. The size of a syndicate varies according to the size and difficulty of the bond issue. Syndicates may include large national underwriters and smaller firms located in the state or region where the bonds are being issued. Most syndicates last about 30 days, or shorter if the bonds sell quickly.

The syndicate buys the bond issue from the government borrower at one price and sells them to investors at another, higher price. The difference between the price paid to the issuer and the prices at which the bonds are offered to investors is known as the underwriters' discount or spread and constitutes the profit the underwriter receives for its services. The amount of the spread depends on a variety of factors but is based on the size and complexity of the issue, the marketability of the bonds and current market conditions. The underwriters' discount consists of four components, determined independently:

- A management fee. In the case of a syndicate, the management fee is split among the lead managers or co-managers, but not with the entire syndicate.
- An underwriting fee or "risk" component, which is the amount set aside to absorb potential losses from buying an entire bond issue before receiving orders from investors for all of the bonds. It protects the underwriter in the event of dramatic market shifts.
- Expenses to compensate for the physical costs of underwriting and running a syndicate including travel and printing costs and legal fees.
- The "takedown" representing the discount at which the underwriter or syndicate buys or "takes down" bonds. The amount of the takedown depends on how difficult the bonds will be to market to investors. Occasionally an underwriter who is not a member of a syndicate will have a client who wants to buy bonds from the bond issue. The nonmember underwriter may buy the bonds from the syndicate for its cus-

tomer. The nonmember's profit is known as the selling concession and is taken out of the takedown.

The underwriting period takes approximately a month from the time the issue is sold and the physical delivery of the bonds. All members of the syndicate receive, and agree to the terms contained in, a letter from the senior manager describing the offering terms, which include the spread, takedown price and selling concessions. In order to pay the issuer, the senior manager arranges for a loan from a commercial bank, which may be a member of the syndicate. The loan is used to pay the issuer. The bonds are physically delivered and distributed among the members, who fill their orders and send the payments to the senior manager. Once the manager has received all the payments from the syndicate members, the manager retires the loan and distributes the profits among the members. The senior manger's last step is to issue a final statement of participants, expenses and profits.

2. *Public Bid and Private Sale*:

The goal of the government entity issuing bonds is to make the sale at the lowest issuance cost and interest rate. Two methods of conducting sales of bonds have been developed and are in general use: a public competitive bid and a private negotiated sale.

In a competitive bid sale, the issuer conducts all of the tasks necessary to offer the bonds, usually with the assistance of outside consultants, including a financial advisor and bond counsel. These tasks include structuring the maturity schedule, preparing an official statement, verifying legal documents, obtaining a bond rating and any desirable credit enhancements and timing the sale. Underwriting syndicates submit bids in the manner required by the notice. The bonds are awarded to the syndicate that has submitted the best bid, i.e., the lowest true interest cost.

Arizona law generally allows private negotiated bond sales as an option to competitive bidding, despite the Arizona procurement code, which would otherwise only allow a public bid for issues of state bonds. (See, e.g., A.R.S. § 28-7503, paragraph 5.) A negotiated sale is a sale through an exclusive agreement with an underwriter or syndicate selected by the issuer on the basis of expertise, financial resources, compatibility or previous experience. After the syndicate is selected, the senior manager of the syndicate works with the issuer to structure the bond issue and complete the other origination tasks, engages in pre-sale marketing and negotiates the interest rates and purchase price with the issuer. The issuer usually engages the assistance of a financial advisor to represent the issuer's interests in the process.

The issuer's decision to sell at public or private sale will be based on many factors as reviewed with the financial advisors. There is no clear advantage for one process over the other that applies in all cases. The deciding factors depend on the characteristics of the issuer, the market and the potential underwriters and must be determined on a sale-by-sale basis.

E. Arbitrage:

When an issuer sells the bonds to an underwriter or syndicate, it collects a lot of money not all of which can be used immediately. The proceeds of a bond issue are usually put into short-term investments until they are spent on their intended use. The difference between the interest paid by the issuer on its tax-exempt bonds and the interest the issuer earns from investing the bond proceeds in taxable securities is called "arbitrage". If the yield on the bonds is greater than the yield on an investment, the investment is said to have "negative arbitrage" associated with it. If the yield on the investment is greater than the yield on the bonds, the investment is said to have "positive arbitrage". Of course, the issuer ideally wants to earn money from investing bond proceeds.

The federal government regulates arbitrage activity to prevent government entities from abusing their tax-exempt bonding power for the purpose of earning arbitrage. Federal Internal Revenue Service (IRS) regulations generally limit arbitrage to ⅛ of 1% above the interest rate on the issuer's tax-exempt bonds. A violation of this limit may result in the IRS designating the issuer's bonds as "arbitrage bonds" and disqualifying them from tax-exempt status, thus seriously impairing their marketability.

There are options and exceptions to avoid disqualification. The issuer may purchase special low-yield federal securities called the state and local government series if normal market securities are earning more than the maximum allowed arbitrage. If the issuer does earn more than the maximum arbitrage due to unforeseen events, the issuer must rebate the excess earnings to the United States treasury to avoid disqualification. Arbitrage may be earned for certain temporary periods if the bond proceeds are used for certain kinds of projects and spent within specified periods of time. At the end of the temporary period, the issuer must restrict the yield on the remaining proceeds.

V. DEBT INSTRUMENTS

A. Description:

"Municipal securities" and "municipal bonds" refer generically to interest-bearing obligations that are issued by state and local governments as evidence of borrowing money to finance capital (and occasionally operating) costs.

Municipal bonds are usually sold in denominations of $5,000 or multiples of $5,000. Each bond is identified by at least four pieces of information:

- The name of the governmental body issuing the bond and incurring the debt.
- The interest rate or rate of gain stated on the bond and payable to the bondholder. The rate is commonly referred to as "the coupon" whether or not a physical coupon is actually attached. The interest is usually paid semiannually.
- The maturity date on which the investor will receive payment of the principal and the final interest payment.
- The yield on the investment, which accounts for both the purchase price of the bond and its interest rate. If a bond is purchased below par, the yield will be greater than the stated interest rate. If the bond is purchased above par (at a premium), the yield will be less than its rate of interest.

The interest income on municipal bonds has historically been exempt from federal income tax. Thus, they are commonly referred to as "tax-exempt bonds". Because of the tax exemption feature, state and local governments are able to borrow money at a significant savings compared to the cost if the interest paid were taxable. Investors are willing to accept lower yields when lending money to the government because, of course, they too benefit from the tax exemption. An investor in the 28% federal tax bracket would have to earn 9.72% on a taxable bond for it to be equivalent to a 7% municipal bond. The savings is even greater to an Arizona taxpayer who buys tax-exempt bonds issued in Arizona because their interest is also exempt from Arizona income tax. (Municipal bonds issued outside Arizona are not exempt from Arizona income tax.)

In past years municipal bonds were in the form of "bearer bonds", which were negotiable by anyone who held them and could prove ownership. Bearer bonds had coupons attached representing interest due. Every six months the holder had to physically clip the coupon and present it to a bank for collection from the issuer's paying agent. Some bearer bonds are still available in the marketplace.

Since July, 1983 as a result of federal tax law changes, municipal bonds have been issued in "registered" form. With a registered bond, the owner's name is registered on the issuer's books and appears on the face of the bond. Registered bonds pay interest without having to clip coupons. The holder automatically receives the interest as well as the principal when due. The owner of a registered bond can transfer ownership of the bond only with the proper endorsement and documentation. A growing number of municipal bonds are issued in "book-entry" form. Ownership and transfers are recorded through data entries at a central clearinghouse rather than by conveyance of the physical bond.

B. Long-term Debt:

1. General Obligation Bonds:

General obligation bonds (GO bonds) are bonds that are secured by the "full faith and credit" of an issuer--in other words, the *full* taxing power of the state or the local government. General obligation bonds constitute debts of the issuer and normally require approval by an election before they can be issued. The government is legally obligated to use its taxing power, if necessary, to repay the debt, and in the event of default, the holders of GO bonds have the right to compel a tax levy in order to satisfy the issuer's obligation on the defaulted bonds.

Since GO bonds are legally backed by the issuer's full faith and credit, they are considered very low risk for investors, and they usually sell at the lowest rates of interest. A GO bond issue is usually less complex than other types of bonds, reducing administrative costs associated with the issue.

Voter approval of the GO bond issue indicates political support for the financing arrangement. On the other hand, voter approval may delay or defeat the financing and may cause the underlying project to be abandoned. Under some circumstances, the government may not even consider a project as being viable if voter approval is required to finance it.

Under the Arizona Constitution and statutes, some political subdivisions have limitations on the amount of general obligation debt they can incur. These limitations are intended to prevent private property from becoming overburdened with property tax liens imposed to support government debt.

General obligation bonds place a burden on all property taxpayers, regardless of whether they receive any special benefit from the project being financed. A flood control project may not have any direct benefit to a taxpayer living in another watershed, and that taxpayer may resent having to finance the project with his tax dollars. Similarly, elderly taxpayers may resist obligating their property to finance an elementary school cafeteria. Under these circumstances, the government must evaluate whether a rational political argument can be framed for distributing the burden of financing its projects among all taxpayers.

2. *Revenue Bonds*:

Revenue bonds are legally secured only by a specifically identified revenue source, not the full faith and credit or the general taxing power of the government. If that revenue source is insufficient to make the debt service payments, the government is not legally obligated to use any other revenues for the debt repayment. Revenue bondholders have no right to compel taxation or appropriation of money not pledged for bond payment.

The revenues pledged to a revenue bond issue may be derived from the operation of a financed project (such as from a sports stadium or coliseum or from wholesale electricity sales), from grants or from specifically identified and dedicated excise or other non-ad valorem taxes. Usually, revenue bonds do not require voter approval prior to issuance, although an election may be required by law in particular cases. Revenue bonds may be an appropriate mechanism for placing the burden of financing a project on the users or beneficiaries of the project. The lack of voter approval and public participation occasionally produces public reaction and resentment of the project that is approved and financed out of the public spotlight.

When compared with GO bonds, revenue bonds cost more in interest payments because the source of repayment is not as legally secure and the risk of default is considered to be greater. If the bonds are defaulted, the government is not legally responsible. In reality, however, if a government is not willing to make the necessary revenue available to service revenue bond debt, there will be a negative reaction by the bond market toward the issuer. Revenue bond issues are also more complex in terms of preparation and administration, and they are more likely to involve a negotiated sale, rather than competitive bidding, incurring higher underwriting costs.

3. *Zero Coupon and Capital Appreciation Bonds*:

Usually, governments make interest payments on their bonds semiannually. There may be times, however, when it is more advantageous not to make any periodic payments but wait instead until the bonds' maturity date and make a single lump sum payment of all obligations on the debt. Zero coupon bonds ("zeros") and capital appreciation bonds (CABs) are two variants of both general obligation and revenue bonds that provide for lump sum payments on the maturity date.

Zero coupon bonds bear no interest. The bond is sold at a discount and at maturity is repaid at full face value. Until maturity, the issuer makes no payments to the bondholder. The difference between the discount price and full value of the bond represents the bondholder's gain, but it is not "interest" in any legal sense. To be marketable, the zero bond issue must be structured to produce gain comparable to market interest reinvested (compounded) during the life of the bond. Since the bond is sold at a discount, the issuer must use a larger par value (face value) to produce a given amount of net proceeds. The limits on government debt apply to the par value of bonds, and zeros use up a lot of a government's debt capacity to produce a lower amount of proceeds. Moreover, the issuer must accumulate a significant fund of money to make what amounts to a balloon payment on the maturity date.

Capital appreciation bonds are sold at face value, but the interest is held by the issuer and compounded at the stated rate. On the maturity date the issuer pays a lump sum, representing both the principal and the accumulated interest.

4. Refunding Bonds:

Occasionally during the term of a bond issue events occur that make it advantageous to replace an outstanding debt issue with a new debt issue. This procedure is called refunding whereby the issuer refinances an outstanding bond issue by issuing new bonds in an amount sufficient to cover the

PRIVATE ACTIVITY BONDS

Private activity bonds are special kinds of revenue bonds that are used entirely or partly for private, rather than government, purposes and are given federal tax-exempt status. (Section 141 of the Internal Revenue Code.) This favorable treatment is provided on the assumption that certain types of private activities also provide significant public benefit as well and should be encouraged through tax incentives. Federal law provides categorical definitions for private activity bonds:

- Financing certain types of facilities such as airports and other mass transit facilities, water and sewage treatment facilities, solid waste facilities, hazardous waste facilities, local electrical or gas facilities, etc.
- Financing multifamily and single family housing.
- Financing veterans' housing.
- Industrial development bonds for small manufacturing facilities.
- Student loan bonds.
- Distressed area or redevelopment zone redevelopment bonds.
- Qualified 501(c)(3) bonds used to finance facilities for nonprofit corporations.

Federal law places substantial limitations on the use of private activity bonds as well as a volume cap on private activity bonds issued for certain authorized purposes. Moreover, bondholders may not be substantial users of the facility financed with the bonds. Other restrictions affect the maturity of the bonds and the amount of the bonds that can be used to purchase land associated with the financed facility.

principal, interest and call premium of the old bonds. The new bonds are called "refunding bonds", and the outstanding obligations being refinanced are referred to as the "refunded bonds" or the "prior issue". Refunding may be done in several circumstances under conditions and limitations prescribed by law:

- Lower interest rates are the most common reason for refunding.
- During a recession, refunding may be used to stretch out or defer debt service obligations until the issuer's financial situation improves.
- Refunding may be used to remove a burdensome or restrictive covenant imposed by the terms of the original debt issue. This is most common in the case of revenue bonds.

The statutes that authorize refunding in specific cases may place conditions and restrictions on what may be refunded or how refunding may occur. In the case of refunding general obligation bonds, the law may include a provision restricting the aggregate amount of taxes necessary to pay the principal and interest on the refunding bonds to the same aggregate amount of principal and interest remaining outstanding on the refunded bonds. Another restriction may prohibit extending the term to maturity of the indebtedness.

Once the refunding bonds are issued, the proceeds are either:

- Deposited in an escrow account to pay the debt service on the old bonds when due. This occurs when the refunding bonds are issued before the old bonds can be called or retired. These refunding bonds are known as "advance refunding bonds". If the proceeds of advance refunding bonds are invested in secure investment vehicles, the original bonds are considered "defeased" and they are no longer considered a liability of the issuer. Moreover, the rating on the original bonds is upgraded to the highest grade since there is a guaranteed source of repayment. There are numerous federal restrictions on the use of advance refunding bonds because of arbitrage earnings restrictions.
- Used immediately to retire old bonds that are currently callable. These refunding bonds are known as "current refunding bonds". In this case, the old bonds and liens are retired as they are called.

Refunding issues are typically sold through a negotiated sale because of their complexity. The bond issuer targets a level of present value savings, measured as a percentage of the refunded bond issue, as a guideline for determining when to issue refunding bonds. The amount of money saved from refunding depends on several factors, including:

- The difference between the prior and new bond interest rates.
- The maturity date, call date and call premium of the prior bonds.
- The potential yield on escrow investments.
- The cost of issuing the refunding bonds.

SWAP AGREEMENTS

Swap agreements are exotic financial arrangements authorized by state law (A.R.S. Title 35, chapter 8) in which a government borrower agrees with a financial institution (the "counterparties") to make periodic payments to each other, typically based on a "notional" amount of owed principal. Through swap agreements, sophisticated managers can take advantage of various financial principles and accounting legerdemain to achieve specific results that would not be available through direct bond issues, such as lower cost financing, hedging interest rate exposure or restructuring the borrower's debt profile to take advantage of current or expected future market conditions. This could allow, for example, a government borrower to swap a financial advantage in the fixed interest rate market for access to the floating rate market to which access may otherwise be denied.

The earlier a bond issue is refunded, the greater the issuer's savings. When the first call date on a bond has passed, an increasingly lower current interest rate is required on the refunding bonds to achieve a reasonable level of savings. Smaller issues or specific maturities of an issue may not be worth refunding unless the absolute dollar savings justify the refunding issue.

C. Short-term Debt:

1. Notes:

Occasionally the state or local government may need money immediately without the luxury of waiting until the money can be collected or borrowed in the ordinary manner. In these cases, the government may use short-term financing to bridge the gap between incurring expenses and receiving bond revenues. Short-term financing is usually in the form of a "note", a written promise to repay a specified principal amount on a date certain, usually within one year, with interest at a stated rate, payable from a specific source of anticipated revenue. Unlike bonds, interest on short-term notes is usually paid only at maturity. Some categories of notes include:

- Tax anticipation notes (TANs) that are payable from future anticipated tax revenues, such as income taxes or property taxes that are due and payable at set times of the year.
- Revenue anticipation notes (RANs) that are issued in anticipation of other revenue, such as federal or state aid at a future date.
- Grant anticipation notes (GANs) that are issued on the expectation of receiving

grant monies, usually from the federal government.

2. *Tax-exempt Commercial Paper*:

Commercial paper is a very short-term (up to 270 days), unsecured promissory note that is issued in either registered or bearer form, and usually backed by a line of credit with a bank. Commercial paper is often issued in lieu of TANs, RANs, GANs or other notes because of greater flexibility in setting maturities and interest rates.

3. *Variable Rate Demand Obligations*:

Variable rate demand obligations (VRDOs; also known as "demand bonds", "demand notes", "put bonds", "floaters" and "lower floaters") are actually long-term securities, but they have yields determined or set as if they were short-term notes. They developed relatively recently as a result of investor and issuer concerns about fluctuating interest rates in the investment market. The holder of a VRDO is entitled to demand purchase ("put") of the bond by the issuer at par plus accrued interest on a periodic basis (daily, weekly, monthly, quarterly, etc., as specified in the bond issue). The interest rate may also change at the same interval according to changes in the cost of borrowing money. Since the holder can demand payment (on specified notice), the issuer must maintain some form of liquidity or credit support in order to meet the demand. Most VDROs also allow the issuer to convert the security to a fixed interest rate under certain conditions and procedures.

VI. STATUTORY PROVISIONS

This section contains common statutory provisions that provide authority for government entities to issue bonds. It is written as though applying to special districts and public authorities, but can be easily modified and adapted for application with respect to state, county or city bonds. This text should not be considered to be "boilerplate". Drafters should understand that each application is unique and will require that this text be modified to meet the specific requirements of the particular drafting project.

ARTICLE __. FINANCING

__-____. Definitions

1. "*(e.g., wastewater treatment)* PURPOSE" INCLUDES ONE OR MORE OF THE FOLLOWING PURPOSES:

(a) THE PAYMENT OF *(e.g., wastewater treatment district)* OBLIGATIONS.

(b) THE COST OF ACQUIRING, CONSTRUCTING, RECONSTRUCTING, EQUIPPING, MAINTAINING AND REPAIRING A *(e.g., wastewater treatment)* SYSTEM.

(c) THE ACQUISITION OF REAL PROPERTY FOR *(e.g., wastewater treatment)* NEEDS.

(d) THE PAYMENT OF BOND RELATED EXPENSES.

2. "BOND RELATED EXPENSES" MEANS ANY EXPENSES INCURRED BY THE *(e.g., district)* TO ISSUE AND ADMINISTER ITS BONDS INCLUDING UNDERWRITING FEES AND COSTS, TRUSTEE FEES, FINANCIAL CONSULTANT FEES, PRINTING AND ADVERTISING COSTS, PAYING AGENT FEES, TRANSFER AGENT FEES, LEGAL, ACCOUNTING, FEASIBILITY CONSULTANT AND OTHER PROFESSIONAL FEES AND EXPENSES, CREDIT ENHANCEMENT FEES, ATTORNEY AND ACCOUNTING FEES AND EXPENSES RELATED TO CREDIT ENHANCEMENT, BOND INSURANCE OR LIQUIDITY ENHANCEMENT, REMARKETING FEES, RATING AGENCY FEES AND COSTS, TRAVEL AND TELEPHONE EXPENSES AND ALL OTHER EXPENSES CONSIDERED NECESSARY BY THE *(board of directors)* IN ORDER TO MARKET AND ADMINISTER THE BONDS.

3. "BONDS" MEANS THE BONDS OF THE *(district)* ISSUED PURSUANT TO THIS ARTICLE.

4. "REAL PROPERTY FOR *(wastewater treatment)* NEEDS" MEANS THE REAL PROPERTIES AND ANY APPURTENANCES TO THE PROPERTIES THAT ARE DESIGNATED OR MAY BE DESIGNATED BY THE *(district)* AS A LOCATION FOR CONSTRUCTING A *(wastewater treatment)* SYSTEM PROJECT, INCLUDING LANDS AND INTERESTS IN LANDS THE USE OR OCCUPANCY OF WHICH IS NECESSARY OR APPROPRIATE TO CONSTRUCT, RECONSTRUCT, REPAIR, MAINTAIN, EXTEND, DEVELOP, IMPROVE OR OPERATE *(wastewater treatment)* FACILITIES AND IMPROVEMENTS.

__-____. Authorization of bonds

A. THE *(district)* MAY ISSUE NEGOTIABLE BONDS PURSUANT TO THIS ARTICLE IN SUCH PRINCIPAL AMOUNT AS, IN THE OPINION OF THE *(board of directors)*, IS NECESSARY TO:

1. PROVIDE SUFFICIENT MONIES FOR ANY *(wastewater treatment)* PURPOSE.

2. PAY NECESSARY BOND RELATED EXPENSES.

3. ESTABLISH AND FULLY OR PARTIALLY FUND ANY RESERVES OR SINKING ACCOUNTS ESTABLISHED BY THE BOND RESOLUTION.

4. ISSUE REFUNDING BONDS IF THE *(board of directors)* CONSIDERS REFUNDING TO BE EXPEDIENT. THE *(board)* MAY PROVIDE FOR INVESTING AND HOLDING THE PROCEEDS OF THE REFUNDING BONDS IN TRUST FOR THE BENEFIT OF THE HOLDERS OF THE BONDS BEING REFUNDED.

5. REFUND ANY BONDS ISSUED BY THE *(district)* IF THE BONDS ARE SECURED FROM THE SAME SOURCE OF REVENUES AS THE BONDS AUTHORIZED IN THIS ARTICLE BY ISSUING NEW BONDS, WHETHER THE BONDS TO BE REFUNDED HAVE OR HAVE NOT MATURED.

6. ISSUE BONDS PARTLY TO REFUND OUTSTANDING BONDS AND PARTLY FOR ANY *(wastewater treatment)* PURPOSE CONSISTENT WITH THIS ARTICLE.

B. THE *(board)* SHALL AUTHORIZE THE BONDS BY RESOLUTION. THE RESOLUTION SHALL PRESCRIBE:

1. THE MANNER AND METHOD OF SALE.

2. THE RATE OR RATES OF INTEREST, WHICH MAY BE FIXED OR VARIABLE, THE DATE OR DATES ON WHICH INTEREST IS PAYABLE AND THE DENOMINATIONS OF THE BONDS.

2. THE DATE OR DATES OF THE BONDS AND MATURITY. ***[If the bonds are secured by a specific source of revenue, the following sentence may be added here:]*** IF THE *(source of revenue)* HAS A FINAL TERMINATION DATE, ALL BONDS AUTHORIZED UNDER THIS ARTICLE SHALL MATURE AT OR BEFORE THE FINAL TERMINATION DATE.

3. THE MANNER OF EXECUTING THE BONDS.

4. THE MEDIUM AND PLACE OF PAYMENT.

5. THE TERMS OF REDEMPTION, WHICH MAY PROVIDE FOR A PREMIUM FOR EARLY REDEMPTION.

[The following section provides for an election to authorize the governing board to issue bonds and should always be included in the case of general obligation bonds, and in the case of revenue bonds if it is specifically requested.]

[__-____. <u>Bond election</u>

A. ON DETERMINING THE AMOUNT OF MONEY NECESSARY TO BE RAISED FOR ANY *(e.g., wastewater treatment)* PURPOSE, THE *(board)* SHALL IMMEDIATELY CALL [A SPECIAL ELECTION] [AN ELECTION TO BE HELD ON A DATE PRESCRIBED BY SECTION 16-204] AT WHICH THE *(board)* SHALL SUBMIT TO THE ELECTORS OF THE *(district)* THE QUESTION OF WHETHER OR NOT *(district)* BONDS SHOULD BE ISSUED IN THE AMOUNT SO DETERMINED.

B. THE *(board)* SHALL ISSUE A PUBLIC NOTICE OF THE ELECTION THAT SPECIFIES THE DATE OF THE ELECTION, THE AMOUNT OF THE BONDS PROPOSED TO BE ISSUED, THE MAXIMUM RATE OF INTEREST TO BE BORNE ON THE BONDS AND THE DENOMINATIONS OF THE BONDS. THE NOTICE SHALL BE:

1. POSTED IN THREE PUBLIC PLACES IN EACH ELECTION PRECINCT OF THE _(district)_ FOR AT LEAST TWENTY DAYS BEFORE THE ELECTION.

2. PUBLISHED IN A NEWSPAPER OF GENERAL CIRCULATION IN THE COUNTY IN WHICH THE _(district)_ IS LOCATED ONCE A WEEK FOR AT LEAST TWO CONSECUTIVE WEEKS.

C. THE ELECTION SHALL BE HELD AND THE RESULTS SHALL BE DETERMINED AS NEARLY AS PRACTICABLE ACCORDING TO [SECTION __-____, GOVERNING THE ELECTION OF DIRECTORS] [THE GENERAL ELECTION LAWS OF THIS STATE], EXCEPT AS OTHERWISE PROVIDED BY THIS ARTICLE. AN INFORMALITY IN CONDUCTING THE ELECTION DOES NOT INVALIDATE THE ELECTION IF IT WAS OTHERWISE CONDUCTED FAIRLY.

D. THE BALLOT SHALL CONTAIN THE WORDS "BONDS - YES" AND "BONDS - NO". IF A MAJORITY OF THE VOTES CAST AT THE ELECTION APPROVES THE BONDS, THE _(board of directors)_ SHALL CAUSE THE BONDS TO BE ISSUED. IF A MAJORITY OF THE VOTES CAST AT THE ELECTION DISAPPROVES THE BONDS, THE _(board)_ SHALL DECLARE AND ENTER THE RESULT OF THE ELECTION ON ITS RECORD AND SHALL TERMINATE THE ISSUANCE OF BONDS UNDER THIS ARTICLE.

__-____. Issuance and sale of bonds; notice

A. THE _(board)_ SHALL ISSUE THE BONDS IN THE MANNER, METHOD, NUMBER AND AMOUNT PROVIDED IN THE RESOLUTION.

B. THE _(board)_ SHALL PROVIDE NOTICE OF ITS INTENTION TO ISSUE BONDS IN A MANNER CONSISTENT WITH MARKET PRACTICE. [A COPY OF THE NOTICE SHALL BE HAND DELIVERED OR SENT BY CERTIFIED MAIL TO _(any state oversight agency)_ ON OR BEFORE THE LAST DAY OF PUBLICATION.]

C. THE BONDS MAY BE SOLD BY COMPETITIVE BID OR NEGOTIATED SALE FOR PUBLIC OR PRIVATE OFFERING AT THE PRICE AND ON THE TERMS PRESCRIBED IN THE RESOLUTION [AT, ABOVE OR BELOW] [FOR NOT LESS THAN] PAR.

D. THE NET PROCEEDS FROM THE SALE OF THE BONDS SHALL BE DEPOSITED IN THE BOND PROCEEDS FUND ESTABLISHED BY SECTION __-____.

E. TITLE 35, CHAPTER 3, ARTICLE 7 APPLIES TO THE _(board of directors)_ AND TO BONDS ISSUED UNDER THIS ARTICLE.

__-____. Bond proceeds fund

A. IF THE _(district)_ ISSUES BONDS UNDER THIS ARTICLE, THE _(board of directors)_ SHALL ESTABLISH A BOND PROCEEDS FUND CONSISTING OF THE NET PROCEEDS RECEIVED FROM THE SALE OF THE BONDS [AND ANY OTHER MONIES DESIGNATED FOR THE FUND BY THIS ARTICLE].

B. THE _(district)_ MAY USE MONIES IN THE BOND PROCEEDS FUND ONLY FOR _(e.g., wastewater treatment)_ PURPOSES IN THE MANNER PRESCRIBED BY THIS CHAPTER.

C. MONIES IN THE BOND PROCEEDS FUND ARE EXEMPT FROM LAPSING UNDER SECTION 35-190.

D. THE _(district)_ TREASURER OR FISCAL AGENT SHALL ADMINISTER AND ACCOUNT FOR THE BOND PROCEEDS FUND.

__-____. Debt service fund

A. THE *(board of directors)* SHALL ESTABLISH A DEBT SERVICE FUND CONSISTING OF MONIES DESIGNATED AND DEDICATED FOR REPAYMENT OF THE BONDS AND COSTS AND RELATED EXPENSES ASSOCIATED WITH REDEEMING THE BONDS.

B. MONIES IN THE DEBT SERVICE FUND MAY BE USED ONLY FOR THE PURPOSES AUTHORIZED BY THIS ARTICLE.

C. THE *(district)* TREASURER OR FISCAL AGENT SHALL ADMINISTER AND ACCOUNT FOR THE DEBT SERVICE FUND.

__-____. Securing principal and interest

IN CONNECTION WITH ISSUING BONDS AUTHORIZED BY THIS ARTICLE AND TO ENHANCE THE SECURITY OF THE BONDS, THE *(board)* BY RESOLUTION MAY:

1. SEGREGATE THE DEBT SERVICE FUND INTO ONE OR MORE ACCOUNTS AND SUBACCOUNTS AND PROVIDE THAT BONDS ISSUED UNDER THIS ARTICLE MAY BE SECURED BY A LIEN ON ALL OR PART OF THE MONIES PAID INTO THE DEBT SERVICE FUND OR INTO ANY ACCOUNT OR SUBACCOUNT IN THE FUND.

2. PROVIDE THAT THE BONDS ISSUED UNDER THIS ARTICLE ARE SECURED BY A FIRST LIEN ON THE MONIES PAID INTO THE DEBT SERVICE FUND AND PLEDGE AND ASSIGN TO OR IN TRUST FOR THE BENEFIT OF THE HOLDER OR HOLDERS OF THE BONDS ALL OR PART OF THE MONIES IN THE DEBT SERVICE FUND OR AN ACCOUNT OR SUBACCOUNT AS NECESSARY TO SECURE AND PAY THE PRINCIPAL, THE INTEREST AND ANY PREMIUM ON THE BONDS AS THEY COME DUE.

3. ESTABLISH PRIORITIES AMONG BONDHOLDERS BASED ON CRITERIA ADOPTED BY THE *(board)*.

4. SET ASIDE, REGULATE AND DISPOSE OF RESERVES AND SINKING ACCOUNTS.

5. PRESCRIBE THE PROCEDURE, IF ANY, BY WHICH THE TERMS OF ANY CONTRACT WITH BONDHOLDERS MAY BE AMENDED OR ABROGATED, THE AMOUNT OF BONDS THE HOLDERS OF WHICH MUST CONSENT TO AND THE MANNER IN WHICH THE CONSENT MAY BE GIVEN.

6. PROVIDE FOR PAYMENT OF BOND RELATED EXPENSES FROM THE PROCEEDS OF THE SALE OF THE BONDS OR OTHER REVENUES AVAILABLE TO THE *(board)*.

7. PROVIDE FOR THE SERVICES OF TRUSTEES, CO-TRUSTEES, AGENTS, CONSULTANTS AND OTHER SPECIALIZED SERVICES WITH RESPECT TO THE BONDS.

8. PROVIDE ADDITIONAL SECURITY FOR THE BONDS IN THE FORM OF A LINE OF CREDIT, LETTER OF CREDIT, INSURANCE POLICY OR OTHER SECURITY AND:

(a) PAY THE COST OF THE ADDITIONAL SECURITY FROM AMOUNTS PRODUCED FROM THE BOND ISSUE OR FROM OTHER AVAILABLE SOURCES.

(b) ENTER INTO REIMBURSEMENT OBLIGATIONS IN CONNECTION WITH THE ADDITIONAL SECURITY.

9. ENTER INTO, MODIFY, AND TERMINATE SWAP AGREEMENTS PURSUANT TO TITLE 35, CHAPTER 8.

10. REFUND ANY BONDS ISSUED PURSUANT TO THIS ARTICLE, IF THE NEW BONDS ARE SECURED FROM THE SAME SOURCE OF REVENUES AS THE ORIGINAL

BONDS, BY ISSUING NEW BONDS, WHETHER AT OR BEFORE MATURITY OF THE BONDS BEING REFUNDED.

11. ISSUE BONDS PARTLY TO REFUND OUTSTANDING BONDS AND PARTLY FOR ANY OTHER PURPOSE CONSISTENT WITH THIS ARTICLE.

12. TAKE ANY OTHER ACTION THAT IN ANY WAY MAY AFFECT THE SECURITY AND PROTECTION OF THE BONDS OR INTEREST ON THE BONDS.

__-____. Lien of pledge

A. ANY PLEDGE MADE UNDER THIS ARTICLE IS VALID AND BINDING FROM THE TIME WHEN THE PLEDGE IS MADE.

B. THE MONIES PLEDGED AND RECEIVED BY THE ***(board)*** TO BE PLACED IN THE DEBT SERVICE FUND ARE IMMEDIATELY SUBJECT TO THE LIEN OF THE PLEDGE WITHOUT ANY FUTURE PHYSICAL DELIVERY OR FURTHER ACT. ANY LIEN OF ANY PLEDGE IS VALID AND BINDING AGAINST ALL PARTIES WHO HAVE CLAIMS OF ANY KIND AGAINST THE ***(district)***, REGARDLESS OF WHETHER THE PARTIES HAVE NOTICE OF THE LIEN. THE OFFICIAL RESOLUTION OR TRUST INDENTURE OR ANY INSTRUMENT BY WHICH THIS PLEDGE IS CREATED, WHEN ADOPTED BY THE ***(district)***, IS NOTICE TO ALL CONCERNED OF THE CREATION OF THE PLEDGE, AND THOSE INSTRUMENTS NEED NOT BE RECORDED IN ANY OTHER PLACE TO PERFECT THE PLEDGE.

__-____. Bond purchase; cancellation

THE ***(board)*** MAY PURCHASE BONDS FOR CANCELLATION, USING ANY AVAILABLE MONIES, AT A PRICE NOT EXCEEDING THE FOLLOWING:

1. IF THE BONDS ARE REDEEMABLE AT THE TIME OF PURCHASE, THE APPLICABLE REDEMPTION PRICE PLUS ACCRUED INTEREST TO THE NEXT INTEREST PAYMENT DATE.

2. IF THE BONDS ARE NOT REDEEMABLE AT THE TIME OF PURCHASE, THE APPLICABLE REDEMPTION PRICE ON THE FIRST DATE ON WHICH THE BONDS BECOME SUBJECT TO REDEMPTION PLUS ACCRUED INTEREST TO THAT DATE.

__-____. Payment of bonds

A. THE BONDS SHALL BE PAID SOLELY FROM MONIES FROM THE DEBT SERVICE FUND.

B. THE ***(district)*** TREASURER OR FISCAL AGENT SHALL CANCEL ALL BONDS WHEN PAID.

__-____. Use of surplus monies

A. IF A BALANCE REMAINS IN THE BOND PROCEEDS FUND AFTER ALL ACQUISITION, CONSTRUCTION AND RELATED COSTS HAVE BEEN PAID:

1. THE ***(board)*** SHALL CREDIT THE BALANCE TO REPAY ANY OTHER OUTSTANDING BONDED INDEBTEDNESS OF THE ***(district)***.

2. IF THE ***(district)*** HAS NO OUTSTANDING BONDED INDEBTEDNESS, THE REMAINING BALANCE SHALL BE CREDITED TO THE ***(district's)*** GENERAL FUND.

B. IF A BALANCE REMAINS IN THE DEBT SERVICE FUND AFTER PAYMENT OF ALL BONDS, INTEREST AND OTHER CHARGES RELATED TO BONDS ISSUED UNDER

THIS ARTICLE, THE *(board)* SHALL CREDIT THE BALANCE TO THE *(district's)* GENERAL FUND.

__-____. Investment of monies in the bond proceeds fund

A. THE *(board)* MAY AUTHORIZE THE *(district)* TREASURER OR FISCAL AGENT TO INVEST MONIES IN THE BOND PROCEEDS FUND IN THE MANNER PRESCRIBED BY SECTION __-____.

B. THE ORDER DIRECTING AN INVESTMENT SHALL STATE A DATE ON WHICH THE PROCEEDS FROM THE SALE OF THE BONDS WILL BE NEEDED FOR USE, AND THE TREASURER OR FISCAL AGENT SHALL MAKE THE INVESTMENT IN SUCH A WAY AS TO MATURE AT THE SPECIFIED DATE.

C. ALL MONIES EARNED AS INTEREST OR OTHERWISE DERIVED FROM THE INVESTMENT OF THE MONIES IN THE BOND PROCEEDS FUND SHALL BE CREDITED TO THE DEBT SERVICE FUND.

__-____. Investment of monies in the debt service fund

A. THE *(board of directors)* MAY AUTHORIZE THE *(district)* TREASURER OR FISCAL AGENT TO INVEST AND REINVEST ANY MONIES IN THE DEBT SERVICE FUND AS PROVIDED BY SECTION __-____.

B. ALL MONIES EARNED AS INTEREST OR OTHERWISE DERIVED FROM THE INVESTMENT OF THE MONIES IN THE DEBT SERVICE FUND SHALL BE CREDITED TO THAT FUND.

__-____. Authorized investments of fund monies

A. THE MONIES IN EITHER THE BOND PROCEEDS FUND OR THE DEBT SERVICE FUND MAY BE INVESTED AND REINVESTED AT THE DIRECTION OF THE *(board of directors)* IN ANY OF THE FOLLOWING:

1. UNITED STATES TREASURY OBLIGATIONS.
2. CONSOLIDATED FARM LOAN BONDS.
3. OBLIGATIONS ISSUED BY THE FEDERAL INTERMEDIATE CREDIT BANKS OR BY BONDS FOR COOPERATIVES ON AUTHORITY OF THE FARM CREDIT ACT OF 1933.
4. ANY OTHER OBLIGATIONS GUARANTEED BY THE UNITED STATES GOVERNMENT.
5. ANY INVESTMENTS THAT ARE AUTHORIZED BY ANY OTHER AGENCIES OF THE UNITED STATES GOVERNMENT AND THAT ARE AUTHORIZED TO SECURE PUBLIC DEPOSITS.
6. STATE AND LOCAL GOVERNMENT SERIES UNITED STATES TREASURY SECURITIES.
7. STATE, COUNTY OR MUNICIPAL BONDS ISSUED IN THIS STATE AND ON WHICH THE PAYMENTS OF INTEREST HAVE NOT BEEN DEFERRED.
8. INVESTMENT AGREEMENTS AND REPURCHASE AGREEMENTS COLLATERALIZED BY INVESTMENTS DESCRIBED IN PARAGRAPHS 1 THROUGH 5.

B. THE *(board)* MAY PLACE ANY RESTRICTIONS ON REINVESTMENT YIELD ON THE BONDS OR ON ANY MONIES PLEDGED TO PAY THE BONDS IF NECESSARY TO COMPLY WITH FEDERAL INCOME TAX LAWS AND REGULATIONS TO GAIN ANY FEDERAL TAX BENEFITS AVAILABLE WITH RESPECT TO THE BONDS. MONIES SHALL BE IN-

VESTED UNDER THIS SECTION IN A MANNER THAT AVOIDS ARBITRAGE PENALTIES PRESCRIBED BY FEDERAL LAW.

C. THE PURCHASE OF THE SECURITIES SHALL BE MADE BY THE TREASURER OR FISCAL AGENT ON AUTHORITY OF A RESOLUTION OF THE _*(board)*_. THE TREASURER OR FISCAL AGENT SHALL ACT AS CUSTODIAN OF ALL SECURITIES PURCHASED.

__-____. Fiscal agent; deposit and disbursement of monies

[In the case of bonds issued by the state, the state treasurer would act as fiscal agent, and this section would not apply. In the case of a special district or authority, subsection A could be placed among the board of directors' general powers and duties.]

A. THE _*(board of directors)*_ MAY APPOINT A TREASURER OR BOND TRUSTEE TO SERVE AS FISCAL AGENT TO DEPOSIT, HOLD, INVEST AND DISBURSE THE _*(district's)*_ MONIES.

B. NO MONIES DERIVED FROM SELLING BONDS UNDER THIS ARTICLE OR PLEDGED OR ASSIGNED TO OR IN TRUST FOR THE BENEFIT OF THE HOLDER OR HOLDERS OF THE BONDS MAY BE PAID INTO THE STATE [OR COUNTY OR MUNICIPAL] TREASURY. THE FISCAL AGENT SHALL DEPOSIT ALL SUCH MONIES IN FINANCIAL INSTITUTIONS THAT THE _*(board of directors)*_ DESIGNATES AND THAT ARE INSURED BY AN AGENCY OR INSTRUMENTALITY OF THE UNITED STATES.

C. THE MONIES OF THE _*(district)*_ SHALL BE DISBURSED AS THE _*(board)*_ DIRECTS AND ACCORDING TO THE TERMS OF ANY AGREEMENTS WITH THE HOLDER OR HOLDERS OF THE BONDS.

D. THIS SECTION SHALL NOT BE CONSTRUED AS LIMITING THE POWER OF THE _*(board of directors)*_ TO AGREE IN CONNECTION WITH THE ISSUANCE OF ANY OF ITS BONDS AS TO THE CUSTODY AND DISPOSITION OF THE MONIES RECEIVED FROM SELLING BONDS OR FROM THE INCOME AND REVENUES PLEDGED OR ASSIGNED TO OR IN TRUST FOR THE BENEFIT OF THE HOLDER OR HOLDERS OF THE BONDS.

__-____. Audit

A. THE _*(board of directors)*_ SHALL CAUSE AN ANNUAL AUDIT TO BE MADE OF THE BOND PROCEEDS FUND AND THE DEBT SERVICE FUND, INCLUDING ALL ACCOUNTS AND SUBACCOUNTS IN THE FUNDS. A CERTIFIED PUBLIC ACCOUNTANT SHALL CONDUCT THE AUDIT WITHIN NINETY DAYS AFTER THE END OF THE FISCAL YEAR.

B. THE _*(board)*_ SHALL IMMEDIATELY FILE A CERTIFIED COPY OF THE AUDIT WITH THE AUDITOR GENERAL. THE AUDITOR GENERAL MAY MAKE ANY FURTHER AUDITS AND EXAMINATIONS THAT ARE CONSIDERED TO BE NECESSARY AND MAY TAKE APPROPRIATE ACTION RELATING TO THE AUDIT OR EXAMINATION PURSUANT TO TITLE 41, CHAPTER 7, ARTICLE 10.1. IF THE AUDITOR GENERAL TAKES NO OFFICIAL ACTION WITHIN THIRTY DAYS AFTER THE AUDIT IS FILED, THE AUDIT IS CONSIDERED TO BE SUFFICIENT.

C. THE _*(board)*_ SHALL PAY NEGOTIATED AND APPROVED FEES AND COSTS OF THE CERTIFIED PUBLIC ACCOUNTANT AND AUDITOR GENERAL UNDER THIS SECTION FROM THE DEBT SERVICE FUND.

___-_____. Characteristics of bonds; negotiable; obligation; legal investments; exemption from taxation

A. SUBJECT TO ANY REGISTRATION REQUIREMENTS, THE BONDS ISSUED UNDER THIS ARTICLE ARE FULLY NEGOTIABLE WITHIN THE MEANING AND FOR ALL PURPOSES OF THE UNIFORM COMMERCIAL CODE REGARDLESS OF WHETHER THE BONDS ACTUALLY CONSTITUTE NEGOTIABLE INSTRUMENTS UNDER THE UNIFORM COMMERCIAL CODE.

B. THE BONDS, THEIR TRANSFER AND THE INCOME FROM THE BONDS ARE AT ALL TIMES FREE FROM TAXATION IN THIS STATE.

C. BONDS ISSUED UNDER THIS ARTICLE:

1. ARE PAYABLE ONLY ACCORDING TO THEIR TERMS.

2. ARE OBLIGATIONS OF THE ***(district)*** OR ITS ***(board of directors)***, AND ARE NOT GENERAL, SPECIAL OR OTHER OBLIGATIONS OF THIS STATE [OR THE COUNTY].

3. DO NOT CONSTITUTE A DEBT OF THIS STATE [OR THE COUNTY].

4. ARE NOT ENFORCEABLE AGAINST THIS STATE [OR THE COUNTY] NOR IS PAYMENT OF THE BONDS ENFORCEABLE OUT OF ANY MONIES OTHER THAN THE INCOME OR REVENUE PLEDGED AND ASSIGNED TO, OR IN TRUST FOR THE BENEFIT OF, THE HOLDER OR HOLDERS OF THE BONDS.

5. ARE GOVERNMENT OBLIGATION SECURITIES FOR INVESTMENT BY:

(a) PUBLIC OFFICERS AND BODIES OF THIS STATE AND OF COUNTIES, MUNICIPALITIES AND OTHER POLITICAL SUBDIVISIONS OF THIS STATE.

(b) INSURANCE COMPANIES, ASSOCIATIONS AND OTHER PERSONS CARRYING ON AN INSURANCE BUSINESS.

(c) FINANCIAL INSTITUTIONS, INVESTMENT COMPANIES AND OTHER PERSONS CARRYING ON A BANKING BUSINESS.

(d) FIDUCIARIES.

(e) ALL OTHER PERSONS WHO ARE AUTHORIZED TO INVEST IN GOVERNMENT OBLIGATIONS.

6. ARE SECURITIES THAT MAY BE DEPOSITED WITH PUBLIC OFFICERS OR BODIES OF THIS STATE AND COUNTIES, MUNICIPALITIES AND OTHER POLITICAL SUBDIVISIONS OF THIS STATE FOR PURPOSES THAT REQUIRE THE DEPOSIT OF GOVERNMENT BONDS OR OBLIGATIONS.

___-_____. Effect of changing circumstances on bonds; agreement of state

A. BONDS ISSUED UNDER THIS ARTICLE REMAIN VALID AND BINDING OBLIGATIONS OF THE ***(district)*** NOTWITHSTANDING THAT BEFORE THE DELIVERY OF THE BONDS ANY OF THE PERSONS WHOSE SIGNATURES APPEAR ON THE BONDS CEASE TO BE OFFICERS OF THE ***(district)***.

B. AN AMENDMENT OF ANY PROVISION IN THIS CHAPTER DOES NOT DIMINISH OR IMPAIR THE VALIDITY OF BONDS ISSUED UNDER THIS ARTICLE OR THE REMEDIES AND RIGHTS OF BONDHOLDERS.

C. THIS STATE PLEDGES TO AND AGREES WITH THE BONDHOLDERS THAT THIS STATE WILL NOT LIMIT, ALTER OR IMPAIR THE RIGHTS VESTED IN THE ***(district)*** TO COLLECT THE MONIES[, INCLUDING ________________ TAX REVENUES

UNDER SECTION __-____, OR AN EQUIVALENT SOURCE,] NECESSARY TO PRODUCE SUFFICIENT REVENUE TO FULFILL THE TERMS OF ANY AGREEMENTS MADE WITH THE HOLDERS OF THE BONDS, OR IN ANY WAY IMPAIR THE RIGHTS AND REMEDIES OF THE BONDHOLDERS, UNTIL ALL BONDS ISSUED UNDER THIS ARTICLE, TOGETHER WITH INTEREST ON THE BONDS, INTEREST ON ANY UNPAID INSTALLMENTS OF PRINCIPAL OR INTEREST AND ALL COSTS AND EXPENSES IN CONNECTION WITH ANY ACTION OR PROCEEDINGS BY OR ON BEHALF OF THE BONDHOLDERS, ARE FULLY MET AND DISCHARGED. THE ***(board of directors)***, AS AGENT FOR THIS STATE, MAY INCLUDE THIS PLEDGE AND UNDERTAKING IN ITS RESOLUTIONS AND INDENTURES AUTHORIZING AND SECURING ITS BONDS.

__-____. Validity of bonds; legal opinion

A. THIS ARTICLE CONSTITUTES FULL AUTHORITY FOR AUTHORIZING AND ISSUING BONDS WITHOUT REFERENCE TO ANY OTHER LAW OF THIS STATE. NO OTHER STATUTE WITH REGARD TO AUTHORIZING OR ISSUING OBLIGATIONS OR THAT IN ANY WAY IMPEDES OR RESTRICTS PERFORMING THE ACTS AUTHORIZED BY THIS ARTICLE MAY BE CONSTRUED TO APPLY TO ANY PROCEEDINGS TAKEN OR ACTS DONE PURSUANT TO THIS ARTICLE.

B. THE VALIDITY OF BONDS ISSUED UNDER THIS ARTICLE DOES NOT DEPEND ON AND IS NOT AFFECTED BY THE LEGALITY OF ANY PROCEEDING RELATING TO THE ACQUISITION, CONSTRUCTION, IMPROVEMENT OR EXTENSION OF A ***(e.g., wastewater treatment)*** SYSTEM FOR WHICH THE BONDS ARE ISSUED.

C. THE ***(board of directors)*** SHALL SUBMIT ANY BONDS TO BE ISSUED UNDER THIS ARTICLE TO THE ATTORNEY GENERAL [OR OTHER LEGAL COUNSEL] AFTER ALL PROCEEDINGS FOR AUTHORIZING THE BONDS HAVE BEEN COMPLETED. WITHIN FIFTEEN DAYS AFTER SUBMISSION, THE ATTORNEY GENERAL [OR COUNSEL] SHALL EXAMINE AND PASS ON THE VALIDITY OF THE BONDS AND THE REGULARITY OF THE PROCEEDINGS. IF THE BONDS AND PROCEEDINGS COMPLY WITH THIS ARTICLE, AND IF THE BONDS WHEN DELIVERED AND PAID FOR WILL CONSTITUTE BINDING AND LEGAL OBLIGATIONS OF THE ***(district)***, THE ATTORNEY GENERAL [OR COUNSEL] SHALL CERTIFY IN SUBSTANCE THAT THE BONDS ARE ISSUED ACCORDING TO THE CONSTITUTION AND LAWS OF THIS STATE AND THAT THE INTEREST ON THE BONDS WILL BE EXEMPT FROM FEDERAL AND STATE TAXES AS PROVIDED BY LAW.

D. THE BONDS SHALL RECITE THAT THEY ARE REGULARLY ISSUED PURSUANT TO THIS ARTICLE. THAT RECITAL, TOGETHER WITH THE LEGAL OPINION UNDER SUBSECTION C, CONSTITUTES PRIMA FACIE EVIDENCE OF THE LEGALITY AND VALIDITY OF THE BONDS. FROM AND AFTER THE SALE AND DELIVERY OF THE BONDS, THEY ARE INCONTESTABLE BY THIS STATE[, THE COUNTY] OR THE ***(district)***.

[If not already provided, the following section should be placed in the organic statute of the special district or authority that designates the entity as a municipal corporation or political subdivision.]

__-____. Tax exemption

THE ***(district)*** IS REGARDED AS PERFORMING A GOVERNMENTAL FUNCTION IN CARRYING OUT THE PURPOSES OF THIS CHAPTER AND IS NOT REQUIRED TO PAY TAXES OR ASSESSMENTS ON:

1. ANY OF THE PROPERTY ACQUIRED OR CONSTRUCTED.

2. THE ACTIVITIES OF THE *(district)* IN MAINTAINING AND CARING FOR THE PROPERTY.

3. THE MONIES DERIVED FROM THE PROPERTY.

[The following section should be placed with the general statutes for the entity, typically in an article 1.]

__-____. Unlawful interest in real property; violation; classification

A. A MEMBER OF THE ***(board of directors)*** OR AN EMPLOYEE OF THE ***(district)*** SHALL NOT HAVE ANY DIRECT OR INDIRECT FINANCIAL INTEREST IN ANY:

1. REAL PROPERTY FOR ***(wastewater treatment)*** NEEDS, AS DEFINED IN SECTION __-____, PURCHASED WITH MONIES DERIVED FROM ISSUING BONDS.

2. ENTITY THAT CONTRACTS WITH THE ***(district)*** FOR ANY ***(wastewater treatment)*** NEEDS.

B. A PERSON WHO VIOLATES THIS SECTION IS GUILTY OF A CLASS 2 MISDEMEANOR.

VII. GLOSSARY

Ad Valorem Tax

[Latin: to the value added] A tax based on a valuation of property. Otherwise called a "property tax".

Advance Refunding

The process of refinancing outstanding bonds by issuing a series of "refunding bonds" before the outstanding bonds can be redeemed, ordinarily for the purpose of replacing a higher interest debt with a lower interest debt.

Amortization of Debt

The process of paying the principal amount of a bond issue by periodic payments rather than as a lump sum. Payments are usually computed to include interest in addition to a partial payment of the principal.

Arbitrage

The difference between the interest paid on an issue of tax-exempt municipal bonds and the interest earned from higher-yielding taxable securities that are purchased with the proceeds of the municipal bonds. Internal Revenue Service regulations limit the amount and conditions under which arbitrage is permissible in order to prevent abuse of tax-exempt financing of municipal debt.

Arbitrage Bonds

Municipal bonds that violate federal arbitrage regulations and thereby lose their tax exempt status.

Authority

(See "Public Authority")

Authorizing Resolution

With respect to an issue of municipal bonds, the document that is adopted by the issuer and that implements its power to issue the bonds. The governing body of the issuer must adopt the resolution, containing the terms and conditions applicable to the bonds, before issuing the bonds.

Balloon Payment

A maturity within a serial bond issue that causes a disproportionately large payment of principal.

Basis Point

Shorthand reference to 1/100 of 1% of yield. If a yield increases from 8.25% to 8.50%, the difference is referred to as a 25 basis point increase.

Bearer Bond

A bond that doesn't identify its owner. It is presumed to be owned by the "bearer" or person who holds it. Before June 30, 1983 most municipal bonds were bearer bonds.

Federal law provides, however, that since that date most municipal bonds must be in registered form.

Bid; Bid Price

The price that the underwriters pay the issuer on the delivery date for a new issue. The bid price is expressed as a percentage of par equal to the par amount plus any premium, less any discounts, all divided by the par amount of the bonds and multiplied by 100%.

Bond

A written evidence of debt, stating the principal amount of the debt, a rate or rates of interest (or a formula for computing the rate) and a maturity date on or by which the entire obligation must be paid. Bonds may be classified according to maturity structure (serial vs. term), source of payment (general obligation vs. revenue), method of transfer (bearer vs. registered), issuer (state, county, municipal, special district, public authority, etc.) and price (discount vs. premium).

Bond Counsel

An attorney or law firm retained by an issuer to give a formal legal opinion that the issuer is authorized to issue proposed securities, that the issuer has met all legal requirements for issuance and that the interest on the securities will be exempt from taxation. Typically the bond counsel will be involved with advising the issuer and reviewing the proceedings from the beginning of the proposed issuance.

Bond Election

The process of approval or disapproval of a bond issue by the electors of the governmental entity issuing the bonds. An election is usually required for general obligation bond issues (See Art. VII, § 13, Constitution of Arizona) but may occasionally be required for specific revenue bonds as well.

Bond Funds

Registered investment companies whose assets are invested in diversified portfolios of bonds.

Bond Insurance

An insurance policy that pledges to make timely payments of principal and interest on a bond or bond issue if the issuer is unable to pay.

Bond Proceeds

The money paid to the issuer by the purchaser or underwriter of a new issue of bonds. These monies are used to finance the project or purpose for which the bonds were issued and costs of issuance as stated in the authorizing resolution.

Bond Register

A record, kept by a transfer agent or registrar on behalf of the issuer, listing the names and addresses of the owners of registered bonds.

Bond Resolution

(See "Authorizing Resolution")

Broker

A person or firm that acts as an intermediary by purchasing and selling bonds and other securities for others rather than for its own account.

CAB

(See "Capital Appreciation Bond")

Call

Prepaying (redeeming) a bond before the stated maturity date according to the call features.

Callable

Subject to payment of the principal and accrued interest before the stated maturity date, with or without payment of a call premium.

Call Features

(See "Redemption Provisions")

Call Premium

Call protection, usually stated as a percentage of the principal amount called, paid as a "penalty" or a "premium" for exercising a call provision.

Call Protection

Particular provisions of call features that partially protect investors from an issuer calling high yield bonds or act as a disincentive to the issuer calling the bonds.

Capital Appreciation Bond (CAB)

A long-term municipal bond, either general obligation or revenue, that is sold at par, but with no periodic payments of principal or interest. Instead, the issuer accumulates the interest component, compounded at a stated rate, and pays both principal and interest at maturity in a lump sum.

Commercial Paper

Very short-term unsecured promissory notes issued by governmental entities, usually backed by a line of credit at a bank.

Competitive Bid; Competitive Underwriting

The sale of bonds to underwriters or syndicates that have submitted competitive bids to purchase the issue from the issuer. The sale is to the best bidder according to criteria included in the notice of sale. (Cf. "Negotiated Sale")

Compound Interest

Accrued interest that is reinvested at a stated rate rather than paid periodically to the investor. Interest that is compounded is added to the outstanding principal, thus increasing the interest-bearing amount. Compound interest is finally paid at maturity.

Cost of Issuance

All expenses that are associated with the sale of a new issue and that are not part of the underwriter's discount, including legal fees, printing costs and rating agency fees. Costs of issuance are usually paid from the proceeds of the bond sale.

Coupon

(1) A detachable part of a bearer bond stating an amount of interest due and the date on which the interest may be collected. The bondholder physically detaches the coupon from the bond and presents it for payment by the issuer's paying agent.
(2) Colloquially, the annual interest rate of any bond.

Coupon Bond

(See "Bearer Bond")

Current Yield

The annual return on the dollar amount paid for a bond, stated as the ratio of interest to the actual market price of a bond. A $1,000 bond that pays $80 per year in interest would have a current yield of 8%.

CUSIP

The Committee on Uniform Security Identification Procedures. Established under the auspices of the American Bankers Association to develop a uniform method of identifying municipal, U.S. government and corporate securities.

Dated Date

The date of a bond issue from which the bondholder is entitled to receive interest, even though the bonds may actually be delivered at some other date.

Dealer

A person or firm that engages in the business of underwriting, trading and selling municipal securities. (Cf. "Broker")

Debt

The amount of money (the outstanding principal) the government still owes bond investors.

Debt Limit

The maximum amount of debt that a municipal bond issuer may incur under constitutional, statutory or city charter provisions. See, e.g., Art. IX, §§ 8, 8.1, Constitution of Arizona.

Debt Service

The annual amount of money (principal, interest and other payments) paid to bond investors on outstanding debt.

Debt Service Fund

A trust account, by whatever name used, into which an issuer deposits money to make debt service payments.

Default

A breach of some covenant, promise or duty imposed by the bond contract. The most serious default occurs when the issuer fails to pay debt service obligations when due. If a default is not cured within a specified period of time, the bondholders or trustee may exercise legal remedies to enforce the bond contract.

Defeasance

Termination of bondholders' rights, interest and lien on final payment of principal and interest and other costs or on provision for future payment provided by issuance of refunding bonds.

Demand Bond

(See "Variable Rate Demand Obligation")

Discount

The amount by which the purchase price of a bond is less than the principal amount or par value.

Double Exemption

Exempt from both state and federal income taxes.

Due Diligence

The process of thorough investigation of a bond issue by underwriter's legal counsel to assure that all material facts are fully disclosed to potential investors and that there are no material omissions or misstatements of fact.

Escrow Account

A trust fund established to hold money and other assets that are pledged for payment of debt service of an outstanding issue.

Excise Tax

A tax levied on the possession, manufacture, sale or consumption of commodities or on the privilege of engaging in business. (Cf. "ad valorem (property) taxes" and "capitation (poll) taxes")

Extraordinary Redemption

Redemption of bonds occurring under an unusual circumstance, such as destruction of the facility that was financed with the bonds.

Face Amount

(See "Par Value")

Financial Advisor

A consultant to an issuer of municipal bonds who advises the issuer on the structure, timing, terms and other matters concerning a new bond issue.

Fiscal Year

The 12-month period at the end of which financial positions and results of operations are determined. The fiscal year for state and local governments in Arizona is July 1 - June 30. The federal fiscal year is October 1 - September 30.

Floating-rate Bond

A bond for which the interest rate is adjusted periodically according to a pre-determined formula, based on specific market indicators.

Full Disclosure

The principle that accurate and complete information that a potential investor would find material in making investment decisions must be made available to the prospective purchasers.

Full Faith and Credit

(See "General Obligation Bond")

General Obligation (GO) Bond

A municipal bond that is secured by the issuer's full faith and credit, i.e., the issuer's pledge of its full authority to collect the necessary revenue through its taxing power to repay the bond. GO bonds constitute debts of the issuer and require approval by the voters of the issuing government. In the event of default, holders of GO bonds have the right to compel the issuer to levy a tax to satisfy the obligation on the defaulted bonds.

Grant Anticipation Note (GAN)

(See "Note")

Holder

The owner of a municipal bond. The holder of a bearer bond is the person who has possession of it. The holder of a registered bond is the person whose name is noted on the bond register.

Interest

Compensation paid by a borrower for the privilege of borrowing and using borrowed money. It is in addition to the repayment of the principal amount. It is usually measured and expressed as an annual percentage of the principal amount.

Issuance

The process of authorizing, selling and delivering a new issue of municipal bonds or other municipal securities.

Issue Date

(See "Dated Date")

Issue of Bonds

Bonds that are authorized under a single resolution and have the same dated date, whether sold in one or more series.

Issuer

The state, political subdivision, agency or authority that borrows money through selling bonds or notes.

Legal Opinion

The conclusion of bond counsel, usually printed on the bond, that the proceedings taken in issuing the bond and the bond itself comply with applicable laws and that interest earned on the bond will be exempt from federal and, if applicable, state and local taxes.

Letter of Credit

A commitment, usually by a commercial bank, to honor demands for payment of a debt on compliance with certain conditions or on the occurrence of certain stated events, typically on the borrower's default. Bank letters of credit are used as additional sources of security for municipal bonds and notes.

Manager; Lead Manager

The member or members of an underwriting syndicate charged with primary responsibility in conducting the syndicate's affairs.

Marketability

The ease or difficulty with which securities can be sold in the market. Factors that affect an issue's marketability include the interest rate, security provisions maturity, credit quality and, in the case of a new issue, its size, timing and competing issues.

Market Value

The price at which a security can be traded in the marketplace.

Maturity; Maturity Date

The stated date on which all or a stated part of the principal amount of a bond becomes due and payable.

Maturity Schedule

The schedule of payments of principal of a bond issue.

Moral Obligation Bond

A revenue bond that, in addition to its primary source of security, includes a government pledge to make up shortfalls in the debt service reserve fund, subject to legislative appropriation. There is no legal obligation to make the payment, but the failure to honor the "moral" pledge would have negative consequences for the government's creditworthiness.

Municipal Bond; Municipal Security

A general term referring to bonds and other securities that are issued by states and state agencies and by political subdivisions of states such as counties, cities, towns, special districts and public authorities. Interest on municipal securities is usually free from income taxation.

Negotiated Sale; Negotiated Underwriting

A method of offering and selling a bond issue through a private and exclusive agreement with an underwriter or syndicate chosen by the issuer rather than by competitive bidding.

Noncallable bond

A bond that cannot be redeemed by the issuer before its specified maturity date.

Note

A written, short-term promise by a borrower to repay the principal amount borrowed on a specific date, with interest, payable from a specific source of revenue, such as taxes, federal or state aid and bond proceeds. Notes usually mature in one year or less. Notes that are authorized by Arizona law include tax anticipation notes (TANs), grant anticipation notes (GANs) and revenue anticipation notes (RANs) payable, respectively, from anticipated taxes, grants or other revenues to be collected during the term of the note.

Notice of Sale

An official document produced by an issuer of municipal bonds and announcing the terms of sale of an upcoming bond issue.

Offering Price

The price at which members of an underwriting syndicate for a new issue will offer securities to investors.

Official Statement

A document published by the issuer and disclosing material information on a bond issue, including its purpose, repayment terms and the financial, economic and social characteristics of the issuing government. Investors rely on this information to evaluate the credit quality of the bonds.

Optional Redemption

The right to retire all or part of an issue before its stated maturity during a specified period of years, often at a premium. The right can be exercised at the option of the issuer.

Par

The face amount of a security or the principal amount of a bond or note that must be repaid at maturity.

Paying Agent

The entity that is responsible for transmitting payments of principal and interest from an issuer to the holder of a security. The paying agent is usually a bank or trust company but may also be the issuer's treasurer.

Payment Date

The date on which payments of interest or of principal and interest are due. Interest payment dates usually occur semiannually for fixed rate bonds.

Pledged Revenues

The revenue that is obligated for paying debt service as required by the bond contract. A bond issue places a lien on the pledged revenues.

Point

Shorthand reference to 1% of par value.

Premium

The amount by which the price paid for a security exceeds the security's par value.

Price

The cost of a security, expressed as a percentage of par value.

Primary Market

The marketplace where new issues of municipal bonds and notes are initially sold.

Principal

The face amount or par value of a security payable on the maturity date, exclusive of interest.

Prior Issue

An outstanding issue of municipal bonds, usually used in the context of refunding to designate the bonds being refinanced. It may also designate a previous bond issue that normally possesses a first or senior lien on pledged revenues.

Protective Covenant

Agreement in a bond contract imposing duties on the issuer to protect the interests of the bondholders.

Public Authority

A unit of government that is established to perform specialized functions and financed by service charges, fees or other generated revenues. Authorities usually have the power to issue revenue bonds secured by those revenue sources. (Cf. "Special District")

Put Bond

A bond that carries a put option.

Put Option

A provision in a bond contract that allows the bondholder the right to require the issuer, or the issuer's agent, to purchase the bonds, usually at par, at a time or times in advance of maturity. (Cf. "Redemption Provisions")

Rating Agency

Private organizations that provide public ratings of the credit quality of securities issuers. The two most prominent agencies are Moody's Investors Service, Inc. and Standard & Poor's Corporation.

Ratings

The evaluations of the credit quality of notes and bonds that are made by rating agencies and that indicate the probability of timely payments of principal and interest.

Redemption

A transaction in which the issuer returns the principal outstanding on a bond, plus outstanding interest and any additional charges required by the bond contract.

Redemption Provisions; Call Features

Provisions in a bond contract setting forth the terms and conditions under which the issuer may call or redeem all or part of outstanding bonds, usually after a stated date and at a premium greater than par. (Cf. "Put Option")

Refunding

A procedure for refinancing an outstanding bond issue by, essentially, replacing the outstanding issue with a new bond issue. The proceeds of the new bond issue are used to retire the prior bonds.

Refunding Bonds

New bonds that are issued to refinance, replace and refund a prior bond issue.

Registered Bond

A bond whose owner is listed in records maintained by a registrar and whose ownership cannot be transferred unless the registrar records the transfer on those records.

Revenue Anticipation Note (RAN)

(See "Note")

Revenue Bond

A bond that is payable from a specific source of revenue, other than general tax revenues. Revenue bonds are not backed by the full faith and credit of the issuer, and bondholders may not compel taxation or appropriation of money not pledged for debt service. Voter approval of revenue bond issues is not required by the Constitution of Arizona but may be required by statute in certain instances. Revenue bonds are not "debts" of the issuer for the purpose of constitutional or statutory debt limits. Pledged revenues may be derived from the operation of the financed facility, grants and excise or other specified non-ad valorem taxes.

Secondary Market

The market in which bonds that were previously sold are resold.

Security

(1) Generally, a document evidencing the ownership of an interest in a financial investment, whether an equity investment or a debt investment. The term includes stocks as well as bonds, notes and other negotiable and nonnegotiable evidences of indebtedness or ownership.

(2) The specific revenue sources of an issuer that are pledged for payment of debt service on a bond issue and the covenants and other legal provisions protecting the bondholders' interests.

Serial Bonds

Bonds of an issue that have stated maturities in consecutive years. (Cf. "Term Bonds")

Sinking Fund

A fund used by the issuer to build up a reserve of money to assure the timely payment of debt service.

Special District

Single-purpose or limited-purpose unit of government established to perform specific functions and usually financed by tax levies. Special taxing districts usually have the authority to issue general obligation bonds. (Cf. "Public Authority")

Swap

The sale of a block of bonds and the purchase of another block of similar market value. Swaps may be made to achieve various goals, including establishing a tax loss, upgrading credit quality and extending or shortening maturity.

Syndicate

A group of underwriters formed to purchase (underwrite) a new issue of municipal securities and resell the securities to the general public. One of the underwriters will be designated as the manager to administer the syndicate's operation. The purpose of a syndicate is to share risks, accumulate sufficient capital to underwrite the new issue and assemble a broader market of potential buyers.

Tax Anticipation Note (TAN)

(See "Note")

Taxable Equivalent Yield; Taxable Yield Equivalent

The interest rate a holder must receive on a taxable security to provide the same after-tax return as that earned on a tax-exempt security. The formula for determining the taxable equivalent yield is:

(tax-exempt yield) ÷ (100% - marginal tax bracket) = (taxable equivalent yield)

Tax-exempt Bond

Another term for municipal bond.

Tax-exempt Commercial Paper

(See "Commercial Paper")

Term Bonds

Bonds in an issue that has a single maturity date. (Cf. "Serial Bonds")

Trade Date

The date when a bond transaction is executed.

Trust Agreement; Trust Indenture

A contract between the issuer and a trustee acting on behalf of bondholders. The contract is generally a part of the bond contract and establishes the rights, responsibilities and remedies of the issuer and trustee and determines the exact nature of the security for the bonds.

Trustee

A financial institution designated by the issuer as the custodian of monies and as the official representative of bondholders of a bond issue.

Underwrite

The process of purchasing all or part of a new issue of municipal securities from the issuer and reselling the securities to investors.

Underwriter

A dealer that purchases a new issue of municipal securities for resale to investors.

Variable Rate Demand Obligation (VRDO)

A municipal security that bears interest at a variable rate established at specified intervals and is subject to put options on the date a new interest rate is established.

Yield; Yield to Maturity

The rate of return to the investor assuming that the security is held to maturity and that all interest received over the life of the security is reinvested at the coupon rate of interest. This concept is used when the security is purchased at a price other than par.

Yield Curve

A graphical plot showing the relationship between market yields and maturities for securities of equivalent quality where the Y axis represents the yields and the X axis represents time to maturity. Market conditions at a particular time produce a variety of yield curve configurations:

- If long-term securities have a higher interest rate than short-term securities, the yield curve is normal or positive and inclines on the graph.
- If short-term securities have a higher interest rate than long-term securities, the yield curve is inverted or negative and declines on the graph.
- If short-term and long-term securities have approximately equivalent interest rates, the yield curve is flat.
- If interest rates are low for short-term securities, high for intermediate securities and low for long-term securities, the yield curve is humpbacked or bell-shaped.

Zero Coupon Bond

A bond that is initially sold at a deep discount, bearing no stated interest and payable in a lump sum at par value at maturity. No periodic interest payments are made. The maturity value is equivalent to the principal plus earnings compounded semiannually at the original rate to maturity.

VIII. REFERENCES

Fundamentals of Municipal Bonds. New York: Public Securities Association, Fourth Ed., 1990

World Wide Web sites:

www.styo.com/ (Stone & Youngberg LLC)

www.dbcinc.com/ (DuBois Brown & Co.)

www.investinginbonds.com/ (The Bond Market Association)

www.window.state.tx.us/localinf/debtguide/welcome.html (Texas State Comptroller's Office)